

U.C.C. - ARTICLE 1- GENERAL PROVISIONS (Legal Information Institute - 1996-97 ed.)

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[Comment]

PART 1 SHORT TITLE, CONSTRUCTION, APPLICATION AND SUBJECT MATTER OF THE ACT

§ 1-101. Short Title.

This Act shall be known and may be cited as Uniform Commercial Code.

[Comment]

§ 1-102. Purposes; Rules of Construction; Variation by Agreement.

(1) This Act shall be liberally construed and applied to promote its underlying purposes and policies.

(2) Underlying purposes and policies of this Act are

(a) to simplify, clarify and modernize the law governing commercial transactions;

(b) to permit the continued expansion of commercial practices through custom, usage and agreement of the parties;

(c) to make uniform the law among the various jurisdictions.

(3) The effect of provisions of this Act may be varied by agreement, except as otherwise provided in this Act and except that the obligations of good faith, diligence, reasonableness and care prescribed by this Act may not be disclaimed by agreement but the parties may by agreement determine the standards by which the performance of such obligations is to be measured if such standards are not manifestly unreasonable.

(4) The presence in certain provisions of this Act of the words “**unless otherwise agreed**” or words of similar import does not imply that the effect of other provisions may not be varied by agreement under subsection (3).

(5) In this Act unless the context otherwise requires

(a) words in the singular number include the plural, and in the plural include the singular;

(b) words of the masculine gender include the feminine and the neuter, and when the sense so indicates words of the neuter gender may refer to any gender.

[Comment]

§ 1-103. Supplementary General Principles of Law Applicable.

Unless displaced by the particular provisions of this Act, the principles of law and equity, including the law merchant and the law relative to capacity to contract, principal and agent, estoppel, fraud, misrepresentation, duress, coercion, mistake, Bankruptcy, or other validating or invalidating cause shall supplement its provisions.

[Comment]

§ 1-104. Construction Against Implicit Repeal.

This Act being a general act intended as a unified coverage of its subject matter, no part of it shall be deemed to be impliedly repealed by subsequent legislation if such construction can reasonably be avoided.

[Comment]

§ 1-105. Territorial Application of the Act; Parties' Power to Choose Applicable Law.

(1) Except as provided hereafter in this section, when a transaction bears a reasonable relation to this state and also to another state or nation the parties may agree that the law either of this state or of such other state or nation shall govern their rights and duties. Failing such agreement this Act applies to transactions bearing an appropriate relation to this state.

(2) Where one of the following provisions of this Act specifies the applicable law, that provision governs and a contrary agreement is effective only to the extent permitted by the law (including the conflict of laws rules) so specified:

Rights of creditors against sold goods. Section 2-402.

Applicability of the Article on Leases. Sections 2A-105 and 2A-106.

Applicability of the Article on Bank Deposits and Collections. Section 4-102.

Governing law in the Article on Funds Transfers. Section 4A-507.

Letters of Credit. Section 5-116.

Bulk sales subject to the Article on Bulk Sales. Section 6-103. [Note¹]

Applicability of the Article on Investment Securities. Section 8-110.

Perfection provisions of the Article on Secured Transactions. Section 9-103.

[History²]

[Comment]

§ 1-106. Remedies to Be Liberally Administered.

(1) The remedies provided by this Act shall be liberally administered to the end that the aggrieved party may be put in as good a position as if the other party had fully performed but neither consequential or special nor penal damages may be had except as specifically provided in this Act or by other rule of law.

(2) Any right or obligation declared by this Act is enforceable by action unless the provision declaring it specifies a different and limited effect.

[Comment]

§ 1-107. Waiver or Renunciation of Claim or Right After Breach.

Any claim or right arising out of an alleged breach can be discharged in whole or in part without consideration by a written waiver or renunciation signed and delivered by the aggrieved party.

[Comment]

§ 1-108. Severability.

If any provision or clause of this Act or application thereof to any person or circumstances is held invalid, such invalidity shall not affect other provisions or applications of the Act which can be given effect without the invalid provision or application, and to this end the provisions of this Act are declared to be severable.

[Comment]

§ 1-109. Section Captions.

Section captions are parts of this Act.

[Comment]

PART 2

§ 1-201. General Definitions.

Subject to additional definitions contained in the subsequent Articles of this Act which are applicable to specific Articles or Parts thereof, and unless the context otherwise requires, in this Act:

(1) “**Action**” in the sense of a judicial proceeding includes recoupment, counterclaim, set-

off, suit in equity and any other proceedings in which rights are determined.

(2) “**Aggrieved Party**” means a party entitled to resort to a remedy.

(3) “**Agreement**” means the bargain of the parties in fact as found in their language or by implication from other circumstances including course of dealing or usage of trade or course of performance as provided in this Act (Sections 1-205 and 1-206). Whether an agreement has legal consequences is determined by the provisions of this Act, if applicable; otherwise by the law of contracts (Section 1-103). (Compare “Contract”.)

(4) “**Bank**” means any person engaged in the business of Banking.

(5) “**Bearer**” means the person in possession of an instrument, document of title, or certificated security payable to bearer or indorsed in blank.

(6) “**Bill of lading**” means a document evidencing the receipt of goods for shipment issued by a person engaged in the business of transporting or forwarding goods, and includes an airbill. “**Airbill**” means a document serving for air transportation as a bill of lading does for marine or rail transportation, and includes an air consignment note or air waybill.

(7) “**Branch**” includes a separately incorporated foreign branch of a bank.

(8) “**Burden of establishing**” a fact means the burden of persuading the triers of fact that the existence of the fact is more probable than its non-existence.

(9) “**Buyer in ordinary course of business**” means a person who in good faith and without knowledge that the sale to him is in violation of the ownership rights or security interest of a third party in the goods buys in ordinary course from a person in the business of selling goods of that kind but does not include a pawnbroker. All persons who sell minerals or the like (including oil and gas) at wellhead or minehead shall be deemed to be persons in the business of selling goods of that kind. “Buying” may be for cash or by exchange of other property or on secured or unsecured credit and includes receiving goods or documents of title under a pre-existing contract for sale but does not include a transfer in bulk or as security for or in total or partial satisfaction of a money debt.

(10) “**Conspicuous**”: A term of clause is conspicuous when it is so written that a reasonable person against whom it is to operate ought to have noticed it. A printed heading in capitals (as: Non-Negotiable Bill of Lading) is conspicuous. Language in the body of a form is “conspicuous” if it is in larger or other contrasting type or color. But in a telegram any stated term is “conspicuous”. Whether a term or clause is “conspicuous” or not is for decision by the court.

(11) “**Contract**” means the total legal obligation which results from the parties’ agreement as affected by this Act and any other applicable rules of law. (Compare “Agreement”.)

(12) “**Creditor**” includes a general creditor, a secured creditor, a lien creditor and any representative of creditors, including an assignee for the benefit of creditors, a trustee in Bankruptcy, a receiver in equity and an executor or administrator of an insolvent debtor’s

or assignor's estate.

(13) “**Defendant**” includes a person in the position of defendant in a cross-action or counterclaim.

(14) “**Delivery**” with respect to instruments, documents of title, chattel paper, or certificated securities means voluntary transfer of possession.

(15) “**Document of title**” includes bill of lading, dock warrant, dock receipt, warehouse receipt or order for the delivery of goods, and also any other document which in the regular course of business or financing is treated as adequately evidencing that the person in possession of it is entitled to receive, hold and dispose of the document and the goods it covers. To be a document of title a document must purport to be issued by or addressed to a bailee and purport to cover goods in the bailee's possession which are either identified or are fungible portions of an identified mass.

(16) “**Fault**” means wrongful act, omission or breach.

(17) “**Fungible**” with respect to goods or securities means goods or securities of which any unit is, by nature or usage of trade, the equivalent of any other like unit. Goods which are not fungible shall be deemed fungible for the purposes of this Act to the extent that under a particular agreement or document unlike units are treated as equivalents.

(18) “**Genuine**” means free of forgery or counterfeiting.

(19) “**Good faith**” means honesty in fact in the conduct or transaction concerned.

(20) “**Holder**” with respect to a negotiable instrument, means the person in possession if the instrument is payable to bearer or, in the case of an instrument payable to an identified person, if the identified person is in possession. “Holder” with respect to a document of title means the person in possession if the goods are deliverable to bearer or to the order of the person in possession.

(21) To “**honor**” is to pay or to accept and pay, or where a credit so engages to purchase or discount a draft complying with the terms of the credit.

(22) “**Insolvency proceedings**” includes any assignment for the benefit of creditors or other proceedings intended to liquidate or rehabilitate the estate of the person involved.

(23) A person is “**insolvent**” who either has ceased to pay his debts in the ordinary course of business or cannot pay his debts as they become due or is insolvent within the meaning of the federal bankruptcy law.

(24) “**Money**” means a medium of exchange authorized or adopted by a domestic or foreign government and includes a monetary unit of account established by an intergovernmental organization or by agreement between two or more nations.

(25) A person has “**notice**” of a fact when

(a) he has actual knowledge of it; or

(b) he has received a notice or notification of it; or

(c) from all the facts and circumstances known to him at the time in question he has reason to know that it exists.

A person “**knows**” or has “**knowledge**” of a fact when he has actual knowledge of it. “Discover” or “learn” or a word or phrase of similar import refers to knowledge rather than to reason to know. The time and circumstances under which a notice or notification may cease to be effective are not determined by this Act.

(26) A person “**notifies**” or “gives” a notice or notification to another by taking such steps as may be reasonably required to inform the other in ordinary course whether or not such other actually comes to know of it. A person “**receives**” a notice or notification when

(a) it comes to his attention; or

(b) it is duly delivered at the place of business through which the contract was made or at any other place held out by him as the place for receipt of such communications.

(27) Notice, knowledge or a notice or notification received by an organization is effective for a particular transaction from the time when it is brought to the attention of the individual conducting that transaction, and in any event from the time when it would have been brought to his attention if the organization had exercised due diligence. An organization exercises due diligence if it maintains reasonable routines for communicating significant information to the person conducting the transaction and there is reasonable compliance with the routines. Due diligence does not require an individual acting for the organization to communicate information unless such communication is part of his regular duties or unless he has reason to know of the transaction and that the transaction would be materially affected by the information.

(28) “**Organization**” includes a corporation, government or governmental subdivision or agency, business trust, estate, trust, partnership or association, two or more persons having a joint or common interest, or any other legal or commercial entity.

(29) “**Party**”, as distinct from “**Third Party**”, means a person who has engaged in a transaction or made an agreement within this Act.

(30) “**Person**” includes an individual or an organization (See Section 1-102).

(31) “**Presumption**” or “**presumed**” means that the trier of fact must find the existence of the fact presumed unless and until evidence is introduced which would support a finding of its non-existence.

(32) “**Purchase**” includes taking by sale, discount, negotiation, mortgage, pledge, lien, issue or re-issue, gift or any other voluntary transaction creating an interest in property.

(33) “**Purchaser**” means a person who takes by purchase.

(34) “**Remedy**” means any remedial right to which an aggrieved party is entitled with or without resort to a tribunal.

(35) “**Representative**” includes an agent, an officer of a corporation or association, and a trustee, executor or administrator of an estate, or any other person empowered to act for another.

(36) “**Rights**” includes remedies.

(37) “**Security interest**” means an interest in personal property or fixtures which secures payment or performance of an obligation. The retention or reservation of title by a seller of goods notwithstanding shipment or delivery to the buyer (Section 2-401) is limited in effect to a reservation of a “security interest”. The term also includes any interest of a buyer of accounts or chattel paper which is subject to Article 9. The special property interest of a buyer of goods on identification of those goods to a contract for sale under Section 2-401 is not a “security interest”, but a buyer may also acquire a “security interest” by complying with Article 9. Unless a consignment is intended as security, reservation of title thereunder is not a “security interest”, but a consignment in any event is subject to the provisions on consignment sales (Section 2-326).

Whether a transaction creates a lease or security interest is determined by the facts of each case; however, a transaction creates a security interest if the consideration the lessee is to pay the lessor for the right to possession and use of the goods is an obligation for the term of the lease not subject to termination by the lessee, and

- (a) the original term of the lease is equal to or greater than the remaining economic life of the goods,
- (b) the lessee is bound to renew the lease for the remaining economic life of the goods or is bound to become the owner of the goods,
- (c) the lessee has an option to renew the lease for the remaining economic life of the goods for no additional consideration or nominal additional consideration upon compliance with the lease agreement, or
- (d) the lessee has an option to become the owner of the goods for no additional consideration or nominal additional consideration upon compliance with the lease agreement.

A transaction does not create a security interest merely because it provides that

- (a) the present value of the consideration the lessee is obligated to pay the lessor for the right to possession and use of the goods is substantially equal to or is greater than the fair market value of the goods at the time the lease is entered into,
- (b) the lessee assumes risk of loss of the goods, or agrees to pay taxes, insurance, filing, recording, or registration fees, or service or maintenance costs with respect to the goods,
- (c) the lessee has an option to renew the lease or to become the owner of the goods,
- (d) the lessee has an option to renew the lease for a fixed rent that is equal to or greater than the reasonably predictable fair market rent for the use of the goods

for the term of the renewal at the time the option is to be performed, or

(e) the lessee has an option to become the owner of the goods for a fixed price that is equal to or greater than the reasonably predictable fair market value of the goods at the time the option is to be performed.

For purposes of this subsection (37):

(x) Additional consideration is not nominal if (i) when the option to renew the lease is granted to the lessee the rent is stated to be the fair market rent for the use of the goods for the term of the renewal determined at the time the option is to be performed, or (ii) when the option to become the owner of the goods is granted to the lessee the price is stated to be the fair market value of the goods determined at the time the option is to be performed. Additional consideration is nominal if it is less than the lessee's reasonably predictable cost of performing under the lease agreement if the option is not exercised;

(y) "**Reasonably predictable**" and "**remaining economic life of the goods**" are to be determined with reference to the facts and circumstances at the time the transaction is entered into; and

(z) "**Present Value**" means the amount as of a date certain of one or more sums payable in the future, discounted to the date certain. The discount is determined by the interest rate specified by the parties if the rate is not manifestly unreasonable at the time the transaction is entered into; otherwise, the discount is determined by a commercially reasonable rate that takes into account the facts and circumstances of each case at the time the transaction was entered into.

(38) "**Send**" in connection with any writing or notice means to deposit in the mail or deliver for transmission by any other usual means of communication with postage or cost of transmission provided for and properly addressed and in the case of an instrument to an address specified thereon or otherwise agreed, or if there be none to any address reasonable under the circumstances. The receipt of any writing or notice within the time at which it would have arrived if properly sent has the effect of a proper sending.

(39) "**Signed**" includes any symbol executed or adopted by a party with present intention to authenticate a writing.

(40) "**Surety**" includes guarantor.

(41) "**Telegram**" includes a message transmitted by radio, teletype, cable, any mechanical method of transmission, or the like.

(42) "**Term**" means that portion of an agreement which relates to a particular matter.

(43) "**Unauthorized**" signature means one made without actual, implied, or apparent authority and includes a forgery.

(44) "**Value**". Except as otherwise provided with respect to negotiable instruments and bank collections (Sections 3-303, 4-208 and 4-209) a person gives "value" for rights if he acquires them

- (a) in return for a binding commitment to extend credit or for the extension of immediately available credit whether or not drawn upon and whether or not a charge-back is provided for in the event of difficulties in collection; or
- (b) as security for or in total or partial satisfaction of a pre-existing claim; or
- (c) by accepting delivery pursuant to a pre-existing contract for purchase; or
- (d) generally, in return for any consideration sufficient to support a simple contract.

(45) “**Warehouse receipt**” means a receipt issued by a person engaged in the business of storing goods for hire.

(46) “**Written**” or “**writing**” includes printing, typewriting or any other intentional reduction to tangible form.

[**History**³]

[Comment]

§ 1-202. Prima Facie Evidence by Third Party Documents.

A document in due form purporting to be a bill of lading, policy or certificate of insurance, official weigher’s or inspector’s certificate, consular invoice, or any other document authorized or required by the contract to be issued by a third party shall be prima facie evidence of its own authenticity and genuineness and of the facts stated in the document by the third party.

[Comment]

§ 1-203. Obligation of good faith.

Every contract or duty within this Act imposes an obligation of good faith in its performance or enforcement.

[Comment]

[Permanent Editorial Board Commentary]

§ 1-204. Time; Reasonable Time; “Seasonably”.

(1) Whenever this Act requires any action to be taken within a reasonable time, any time which is not manifestly unreasonable may be fixed by agreement.

(2) What is a reasonable time for taking any action depends on the nature, purpose and circumstances of such action.

(3) An action is taken “**seasonably**” when it is taken at or within the time agreed or if no time is agreed at or within a reasonable time.

[Comment]

§ 1-205. Course of Dealing and Usage of Trade.

(1) A course of dealing is a sequence of previous conduct between the parties to a particular transaction which is fairly to be regarded as establishing a common basis of understanding for interpreting their expressions and other conduct.

(2) A usage of trade is any practice or method of dealing having such regularity of observance in a place, vocation or trade as to justify an expectation that it will be observed with respect to the transaction in question. The existence and scope of such a usage are to be proved as facts. If it is established that such a usage is embodied in a written trade code or similar writing the interpretation of the writing is for the court.

(3) A course of dealing between parties and any usage of trade in the vocation or trade in which they are engaged or of which they are or should be aware give particular meaning to and supplement or qualify terms of an agreement.

(4) The express terms of an agreement and an applicable course of dealing or usage of trade shall be construed wherever reasonable as consistent with each other; but when such construction is unreasonable express terms control both course of dealing and usage of trade and course of dealing controls usage of trade.

(5) An applicable usage of trade in the place where any part of performance is to occur shall be used in interpreting the agreement as to that part of the performance.

(6) Evidence of a relevant usage of trade offered by one party is not admissible unless and until he has given the other party such notice as the court finds sufficient to prevent unfair surprise to the latter.

[Comment]

§ 1-206. Statute of Frauds for Kinds of Personal Property Not Otherwise Covered.

(1) Except in the cases described in subsection (2) of this section a contract for the sale of personal property is not enforceable by way of action or defense beyond five thousand dollars in amount or value of remedy unless there is some writing which indicates that a contract for sale has been made between the parties at a defined or stated price, reasonably identifies the subject matter, and is signed by the party against whom enforcement is sought or by his authorized agent.

(2) Subsection (1) of this section does not apply to contracts for the sale of goods (Section 2-201) nor of securities (Section 8-113) nor to security agreement (Section 9-203).

[History⁴]

[Comment]

§ 1-207. Performance or Acceptance Under Reservation of Rights.

(1) A party who with explicit reservation of rights performs or promises performance or assents to performance in a manner demanded or offered by the other party does not thereby prejudice the rights reserved. Such words as “**without prejudice**”, “**under protest**” or the like are sufficient.

(2) Subsection (1) does not apply to an accord and satisfaction.

[**History**⁵]

[Comment]

§ 1-208. Option to Accelerate at Will.

A term providing that one party or his successor in interest may accelerate payment or performance or require collateral or additional collateral “at will” or “when he deems himself insecure” or in words of similar import shall be construed to mean that he shall have power to do so only if he in good faith believes that the prospect of payment or performance is impaired. The burden of establishing lack of good faith is on the party against whom the power has been exercised.

[Comment]

§ 1-209. Subordinated Obligations.

An obligation may be issued as subordinated to payment of another obligation of the person obligated, or a creditor may subordinate his right to payment of an obligation by agreement with either the person obligated or another creditor of the person obligated. Such a subordination does not create a security interest as against either the common debtor or a subordinated creditor. This section shall be construed as declaring the law as it existed prior to the enactment of this section and not as modifying it.

[**History**⁶]

[⁷ does not create a security interest unless so intended.**Note**]

OFFICIAL COMMENTS - Article 1

Official Comment § 1-101

Each Article of the Code (except this Article and Article 10) may also be cited by its own short title. See Sections 2-101, 3-101, 4-101, 5-101, 6-101, 7-101, 8-101 and 9-101.

Official Comment § 1-102

Prior Uniform Statutory Provision:

Section 74, Uniform Sales Act; Section 57, Uniform Warehouse Receipts Act; Section 52, Uniform Bills of Lading Act; Section 19, Uniform Stock Transfer Act; Section 18, Uniform Trust Receipts Act.

Changes:

Rephrased and new material added.

Purposes of Changes:

1. Subsections (1) and (2) are intended to make it clear that:

This Act is drawn to provide flexibility so that, since it is intended to be a semi-permanent piece of legislation, it will provide its own machinery for expansion of commercial practices. It is intended to make it possible for the law embodied in this Act to be developed by the courts in the light of unforeseen and new circumstances and practices. However, the proper construction of the Act requires that its interpretation and application be limited to its reason.

Courts have been careful to keep broad acts from being hampered in their effects by later acts of limited scope. *Pacific Wool Growers v. Draper & Co.*, 158 Or. 1, 73 P.2d 1391 (1937), and compare Section 1-104. They have recognized the policies embodied in an act as applicable in reason to subject-matter which was not expressly included in the language of the act, *Commercial Nat. Bank of New Orleans v. Canal-Louisiana Bank & Trust Co.*, 239 U.S. 520, 36 S.Ct. 194, 60 L.Ed. 417 (1916) (bona fide purchase policy of Uniform Warehouse Receipts Act extended to case not covered but of equivalent nature). They have done the same where reason and policy so required, even where the subject-matter had been intentionally excluded from the act in general. *Agar v. Orda*, 264 N.Y. 248, 190 N.E. 479 (1934) (Uniform Sales Act change in seller's remedies applied to contract for sale of choses in action even though the general coverage of that Act was intentionally limited to goods "other than things in action.") They have implemented a statutory policy with liberal and useful remedies not provided in the statutory text. They have disregarded a statutory limitation of remedy where the reason of the limitation did not apply. *Fiterman v. J. N. Johnson & Co.*, 156 Minn. 201, 194 N.W. 399 (1923) (requirement of return of the goods as a condition to rescission for breach of warranty; also, partial rescission allowed). Nothing in this Act stands in the way of the continuance of such action by the courts.

The Act should be construed in accordance with its underlying purposes and policies. The text of each section should be read in the light of the purpose and policy of the rule or principle in question, as also of the Act as a whole, and the application of the language should be construed narrowly or broadly, as the case may be, in conformity with the purposes and policies involved.

2. Subsection (3) states affirmatively at the outset that freedom of contract is a principle of the Code: "the effect" of its provisions may be varied by "agreement." The meaning of the statute itself must be found in its text, including

its definitions, and in appropriate extrinsic aids; it cannot be varied by agreement. But the Code seeks to avoid the type of interference with evolutionary growth found in *Manhattan Co. v. Morgan*, 242 N.Y. 38, 150 N.E. 594 (1926). Thus private parties cannot make an instrument negotiable within the meaning of Article 3 except as provided in Section 3-104; nor can they change the meaning of such terms as “bona fide purchaser,” “holder in due course,” or “due negotiation,” as used in this Act. But an agreement can change the legal consequences which would otherwise flow from the provisions of the Act. “Agreement” here includes the effect given to course of dealing, usage of trade and course of performance by Sections 1-201, 1-205 and 2-208; the effect of an agreement on the rights of third parties is left to specific provisions of this Act and to supplementary principles applicable under the next section. The rights of third parties under Section 9-301 when a security interest is unperfected, for example, cannot be destroyed by a clause in the security agreement.

This principle of freedom of contract is subject to specific exceptions found elsewhere in the Act and to the general exception stated here. The specific exceptions vary in explicitness: the statute of frauds found in Section 2-201, for example, does not explicitly preclude oral waiver of the requirement of a writing, but a fair reading denies enforcement to such a waiver as part of the “contract” made unenforceable; Section 9-501(3), on the other hand, is quite explicit. Under the exception for “the obligations of good faith, diligence, reasonableness and care prescribed by this Act,” provisions of the Act prescribing such obligations are not to be disclaimed. However, the section also recognizes the prevailing practice of having agreements set forth standards by which due diligence is measured and explicitly provides that, in the absence of a showing that the standards manifestly are unreasonable, the agreement controls. In this connection, Section 1-205 incorporating into the agreement prior course of dealing and usages of trade is of particular importance.

3. Subsection (4) is intended to make it clear that, as a matter of drafting, words such as “unless otherwise agreed” have been used to avoid controversy as to whether the subject matter of a particular section does or does not fall within the exceptions to subsection (3), but absence of such words contains no negative implication since under subsection (3) the general and residual rule is that the effect of all provisions of the Act may be varied by agreement.

4. Subsection (5) is modelled on 1 U.S.C. Section 1 and New York General Construction Law Sections 22 and 35.

Official Comment § 1-103

Prior Uniform Statutory Provision:

Sections 2 and 73, Uniform Sales Act; Section 196, Uniform Negotiable Instruments Act; Section 56, Uniform Warehouse Receipts Act; Section 51, Uniform Bills of Lading Act; Section 18, Uniform Stock Transfer Act; Section 17, Uniform Trust Receipts Act.

Changes:

Rephrased, the reference to “estoppel” and “validating” being new.

Purposes of Changes:

1. While this section indicates the continued applicability to commercial contracts of all supplemental bodies of law except insofar as they are explicitly displaced by this Act, the principle has been stated in more detail and the phrasing enlarged to make it clear that the “validating”, as well as the “invalidating” causes referred to in the prior uniform statutory provisions, are included here. “Validating” as used here in conjunction with “invalidating” is not intended as a narrow word confined to original validation, but extends to cover any factor which at any time or in any manner renders or helps to render valid any right or transaction.
2. The general law of capacity is continued by express mention to make clear that section 2 of the old Uniform Sales Act (omitted in this Act as stating no matter not contained in the general law) is also consolidated in the present section. Hence, where a statute limits the capacity of a non-complying corporation to sue, this is equally applicable to contracts of sale to which such corporation is a party.
3. The listing given in this section is merely illustrative; no listing could be exhaustive. Nor is the fact that in some sections particular circumstances have led to express reference to other fields of law intended at any time to suggest the negation of the general application of the principles of this section.

Official Comment § 1-104**Prior Uniform Statutory Provision:**

None.

Purposes:

To express the policy that no Act which bears evidence of carefully considered permanent regulative intention should lightly be regarded as impliedly repealed by subsequent legislation. This Act, carefully integrated and intended as a uniform codification of permanent character covering an entire “field” of law, is to be regarded as particularly resistant to implied repeal. See *Pacific Wool Growers v. Draper & Co.*, 158 Or. 1, 73 P.2d 1391 (1937).

Official Comment § 1-105**Prior Uniform Statutory Provision:**

None.

Purposes:

1. Subsection (1) states affirmatively the right of the parties to a multi-state

transaction or a transaction involving foreign trade to choose their own law. That right is subject to the firm rules stated in the five sections listed in subsection (2), and is limited to jurisdictions to which the transaction bears a “reasonable relation.” In general, the test of “reasonable relation” is similar to that laid down by the Supreme Court in *Seeman v. Philadelphia Warehouse Co.*, 274 U.S. 403, 47 S.Ct. 626, 71 L.Ed. 1123 (1927). Ordinarily the law chosen must be that of a jurisdiction where a significant enough portion of the making or performance of the contract is to occur or occurs. But an agreement as to choice of law may sometimes take effect as a shorthand expression of the intent of the parties as to matters governed by their agreement, even though the transaction has no significant contact with the jurisdiction chosen.

2. Where there is no agreement as to the governing law, the Act is applicable to any transaction having an “appropriate” relation to any state which enacts it. Of course, the Act applies to any transaction which takes place in its entirety in a state which has enacted the Act. But the mere fact that suit is brought in a state does not make it appropriate to apply the substantive law of that state. Cases where a relation to the enacting state is not “appropriate” include, for example, those where the parties have clearly contracted on the basis of some other law, as where the law of the place of contracting and the law of the place of contemplated performance are the same and are contrary to the law under the Code.

3. Where a transaction has significant contacts with a state which has enacted the Act and also with other jurisdictions, the question what relation is “appropriate” is left to judicial decision. In deciding that question, the court is not strictly bound by precedents established in other contexts. Thus a conflict-of-laws decision refusing to apply a purely local statute or rule of law to a particular multi-state transaction may not be valid precedent for refusal to apply the Code in an analogous situation. Application of the Code in such circumstances may be justified by its comprehensiveness, by the policy of uniformity, and by the fact that it is in large part a reformulation and restatement of the law merchant and of the understanding of a business community which transcends state and even national boundaries. Compare *Global Commerce Corp. v. Clark-Babbitt Industries, Inc.*, 239 F.2d 716, 719 (2d Cir. 1956). In particular, where a transaction is governed in large part by the Code, application of another law to some detail of performance because of an accident of geography may violate the commercial understanding of the parties.

4. The Act does not attempt to prescribe choice-of-law rules for states which do not enact it, but this section does not prevent application of the Act in a court of such a state. Common-law choice of law often rests on policies of giving effect to agreements and of uniformity of result regardless of where suit is brought. To the extent that such policies prevail, the relevant considerations are similar in such a court to those outlined above.

5. Subsection (2) spells out essential limitations on the parties’ right to choose the applicable law. Especially in Article 9 parties taking a security interest or asked to extend credit which may be subject to a security interest must have sure ways

to find out whether and where to file and where to look for possible existing filings.

6. Section 9-103 should be consulted as to the rules for perfection of security interests and the effects of perfection and nonperfection.

Official Comment § 1-106

Prior Uniform Statutory Provision:

Subsection (1)-none; Subsection (2)-Section 72, Uniform Sales Act.

Changes:

Reworded.

Purposes of Changes and New Matter:

Subsection (1) is intended to effect three things:

1. First, to negate the unduly narrow or technical interpretation of some remedial provisions of prior legislation by providing that the remedies in this Act are to be liberally administered to the end stated in the section. Second, to make it clear that compensatory damages are limited to compensation. They do not include consequential or special damages, or penal damages; and the Act elsewhere makes it clear that damages must be minimized. Cf. Sections 1-203, 2-706(1), and 2-712(2). The third purpose of subsection (1) is to reject any doctrine that damages must be calculable with mathematical accuracy. Compensatory damages are often at best approximate: they have to be proved with whatever definiteness and accuracy the facts permit, but no more. Cf. Section 2-204(3).

2. Under subsection (2) any right or obligation described in this Act is enforceable by court action, even though no remedy may be expressly provided, unless a particular provision specifies a different and limited effect. Whether specific performance or other equitable relief is available is determined not by this section but by specific provisions and by supplementary principles. Cf. Sections 1-103, 2-716.

3. “Consequential” or “special” damages and “penal” damages are not defined in terms in the Code, but are used in the sense given them by the leading cases on the subject.

Cross References:

Sections 1-103, 1-203, 2-204(3), 2-701, 2-706(1), 2-712(2) and 2-716.

Definitional Cross References:

“Action”. Section 1-201.

“Aggrieved Party”. Section 1-201.

“Party”. Section 1-201.

“Remedy”. Section 1-201.

“Rights”. Section 1-201.

Official Comment § 1-107

Prior Uniform Statutory Provision:

Compare Section 1, Uniform Written Obligations Act; Sections 119(3), 120(2) and 122, Uniform Negotiable Instruments Law.

Purposes:

This section makes consideration unnecessary to the effective renunciation or waiver of rights or claims arising out of an alleged breach of a commercial contract where such renunciation is in writing and signed and delivered by the aggrieved party. Its provisions, however, must be read in conjunction with the section imposing an obligation of good faith. (Section 1-203). There may, of course, also be an oral renunciation or waiver sustained by consideration but subject to Statute of Frauds provisions and to the section of Article 2 on Sales dealing with the modification of signed writings (Section 2-209). As is made express in the latter section this Act fully recognizes the effectiveness of waiver and estoppel.

Cross References:

Sections 1-203, 2-201 and 2-209. And see Section 2-719.

Definitional Cross References:

“Aggrieved Party”. Section 1-201.

“Rights”. Section 1-201.

“Signed”. Section 1-201.

“Written”. Section 1-201.

Official Comment § 1-108

This is the model severability section recommended by the National Conference of Commissioners on Uniform State Laws for inclusion in all acts of extensive scope.

Definitional Cross Reference:

“Person”. Section 1-201.

Official Comment § 1-109

Prior Uniform Statutory Provision:

None.

Purposes:

To make explicit in all jurisdictions that section captions are a part of the text of this Act and not mere surplusage.

Official Comment § 1-201

Prior Uniform Statutory Provision, Changes and New Matter:

1. "Action". See similar definitions in Section 191, Uniform Negotiable Instruments Law; Section 76, Uniform Sales Act; Section 58, Uniform Warehouse Receipts Act; Section 53, Uniform Bills of Lading Act. The definition has been rephrased and enlarged.
2. "Aggrieved Party". New.
3. "Agreement". New. As used in this Act the word is intended to include full recognition of usage of trade, course of dealing, course of performance and the surrounding circumstances as effective parts thereof, and of any agreement permitted under the provisions of this Act to displace a stated rule of law.
4. "Bank". See Section 191, Uniform Negotiable Instruments Law.
5. "Bearer". From Section 191, Uniform Negotiable Instruments Law. The prior definition has been broadened.
6. "Bill of Lading". See similar definitions in Section 1, Uniform Bills of Lading Act. The definition has been enlarged to include freight forwarders' bills and bills issued by contract carriers as well as those issued by common carriers. The definition of airbill is new.
7. "Branch". New.
8. "Burden of establishing a fact". New.
9. "Buyer in ordinary course of business". From Section 1, Uniform Trust Receipts Act. The definition has been expanded to make clear the type of person protected. Its major significance lies in Section 2-403 and in the Article on Secured Transactions (Article 9).

The reference to minerals and the like makes clear that a buyer in ordinary course buying minerals under the circumstances described takes free of a prior mortgage created by the sellers. See Comment to Section 9-103.

A pawnbroker cannot be a buyer in ordinary course of business because the person from whom he buys goods (or acquires ownership after foreclosing an initial pledge) is typically an ordinary user and not a person engaged in selling

goods of that kind.

10. "Conspicuous". New. This is intended to indicate some of the methods of making a term attention-calling. But the test is whether attention can reasonably be expected to be called to it.

11. "Contract". New. But see Sections 3 and 71, Uniform Sales Act.

12. "Creditor". New.

13. "Defendant". From Section 76, Uniform Sales Act. Rephrased.

14. "Delivery". Section 76, Uniform Sales Act, Section 191, Uniform Negotiable Instruments Law, Section 58, Uniform Warehouse Receipts Act and Section 53, Uniform Bills of Lading Act.

15. "Document of title". From Section 76, Uniform Sales Act, but rephrased to eliminate certain ambiguities. Thus, by making it explicit that the obligation or designation of a third party as "bailee" is essential to a document, this definition clearly rejects any such result as obtained in *Hixson v. Ward*, 254 Ill.App. 505 (1929), which treated a conditional sales contract as a document of title. Also the definition is left open so that new types of documents may be included. It is unforeseeable what documents may one day serve the essential purpose now filled by warehouse receipts and bills of lading. Truck transport has already opened up problems which do not fit the patterns of practice resting upon the assumption that a draft can move through banking channels faster than the goods themselves can reach their destination. There lie ahead air transport and such probabilities as teletype transmission of what may some day be regarded commercially as "Documents of Title". The definition is stated in terms of the function of the documents with the intention that any document which gains commercial recognition as accomplishing the desired result shall be included within its scope. Fungible goods are adequately identified within the language of the definition by identification of the mass of which they are a part.

Dock warrants were within the Sales Act definition of document of title apparently for the purpose of recognizing a valid tender by means of such paper. In current commercial practice a dock warrant or receipt is a kind of interim certificate issued by steamship companies upon delivery of the goods at the dock, entitling a designated person to have issued to him at the company's office a bill of lading. The receipt itself is invariably nonnegotiable in form although it may indicate that a negotiable bill is to be forthcoming. Such a document is not within the general compass of the definition, although trade usage may in some cases entitle such paper to be treated as a document of title. If the dock receipt actually represents a storage obligation undertaken by the shipping company, then it is a warehouse receipt within this Section regardless of the name given to the instrument.

The goods must be "described", but the description may be by marks or labels and may be qualified in such a way as to disclaim personal knowledge of the issuer

regarding contents or condition. However, baggage and parcel checks and similar “tokens” of storage which identify stored goods only as those received in exchange for the token are not covered by this Article.

The definition is broad enough to include an airway bill.

16. “Fault”. From Section 76, Uniform Sales Act.

17. “Fungible”. See Sections 5, 6 and 76, Uniform Sales Act; Section 58, Uniform Warehouse Receipts Act. Fungibility of goods “by agreement” has been added for clarity and accuracy. As to securities, see Section 8-107 and Comment.

18. “Genuine”. New.

19. “Good faith”. See Section 76(2), Uniform Sales Act; Section 58(2), Uniform Warehouse Receipts Act; Section 53(2), Uniform Bills of Lading Act; Section 22(2), Uniform Stock Transfer Act. “Good faith”, whenever it is used in the Code, means at least what is here stated. In certain Articles, by specific provision, additional requirements are made applicable. See, e.g., Secs. 2-103(1)(b), 7-404. To illustrate, in the Article on Sales, Section 2-103, good faith is expressly defined as including in the case of a merchant observance of reasonable commercial standards of fair dealing in the trade, so that throughout that Article wherever a merchant appears in the case an inquiry into his observance of such standards is necessary to determine his good faith.

20. “Holder”. See similar definitions in Section 191, Uniform Negotiable Instruments Law; Section 58, Uniform Warehouse Receipts Act; Section 53, Uniform Bills of Lading Act.

21. “Honor”. New.

22. “Insolvency proceedings”. New.

23. “Insolvent”. Section 76(3), Uniform Sales Act. The three tests of insolvency- “ceased to pay his debts in the ordinary course of business,” “cannot pay his debts as they become due,” and “insolvent within the meaning of the federal bankruptcy law”-are expressly set up as alternative tests and must be approached from a commercial standpoint.

24. “Money”. Section 6(5), Uniform Negotiable Instruments Law. The test adopted is that of sanction of government, whether by authorization before issue or adoption afterward, which recognizes the circulating medium as a part of the official currency of that government. The narrow view that money is limited to legal tender is rejected.

25. “Notice”. New. Compare N.I.L. Sec. 56. Under the definition a person has notice when he has received a notification of the fact in question. But by the last sentence the act leaves open the time and circumstances under which notice or notification may cease to be effective. Therefore such cases as *Graham v. White-Phillips Co.*, 296 U.S. 27, 56 S.Ct. 21, 80 L.Ed. 20 (1935), are not overruled.

26. “Notifies”. New. This is the word used when the essential fact is the proper dispatch of the notice, not its receipt. Compare “Send”. When the essential fact is the other party’s receipt of the notice, that is stated. The second sentence states when a notification is received.

27. New. This makes clear that reason to know, knowledge, or a notification, although “received” for instance by a clerk in Department A of an organization, is effective for a transaction conducted in Department B only from the time when it was or should have been communicated to the individual conducting that transaction.

28. “Organization”. This is the definition of every type of entity or association, excluding an individual, acting as such. Definitions of “person” were included in Section 191, Uniform Negotiable Instruments Law; Section 76, Uniform Sales Act; Section 58, Uniform Warehouse Receipts Act; Section 53, Uniform Bills of Lading Act; Section 22, Uniform Stock Transfer Act; Section 1, Uniform Trust Receipts Act. The definition of “organization” given here includes a number of entities or associations not specifically mentioned in prior definition of “person”, namely, government, governmental subdivision or agency, business trust, trust and estate.

29. “Party”. New. Mention of a party includes, of course, a person acting through an agent. However, where an agent comes into opposition or contrast to his principal, particular account is taken of that situation.

30. “Person”. See Comment to definition of “Organization”. The reference to Section 1-102 is to subsection (5) of that section.

31. “Presumption”. New.

32. “Purchase”. Section 58, Uniform Warehouse Receipts Act; Section 76, Uniform Sales Act; Section 53, Uniform Bills of Lading Act; Section 22, Uniform Stock Transfer Act; Section 1, Uniform Trust Receipts Act. Rephrased.

33. “Purchaser”. Section 58, Uniform Warehouse Receipts Act; Section 76, Uniform Sales Act; Section 53, Uniform Bills of Lading Act; Section 22, Uniform Stock Transfer Act; Section 1, Uniform Trust Receipts Act. Rephrased.

34. “Remedy”. New. The purpose is to make it clear that both remedy and rights (as defined) include those remedial rights of “self help” which are among the most important bodies of rights under this Act, remedial rights being those to which an aggrieved party can resort on his own motion.

35. “Representative”. New.

36. “Rights”. New. See Comment to “Remedy”.

37. “Security Interest”. See Section 1, Uniform Trust Receipts Act. The present definition is elaborated, in view especially of the complete coverage of the subject in Article 9. Notice that in view of the Article the term includes the interest of

certain outright buyers of certain kinds of property. Section 1-201(37) is being amended at the same time that the Article on Leases (Article 2A) is being promulgated as an amendment to this Act.

One of the reasons it was decided to codify the law with respect to leases was to resolve an issue that has created considerable confusion in the courts: what is a lease? The confusion exists, in part, due to the last two sentences of the definition of security interest in the 1978 Official Text of the Act. Section 1-201(37). The confusion is compounded by the rather considerable change in the federal, state and local tax laws and accounting rules as they relate to leases of goods. The answer is important because the definition of lease determines not only the rights and remedies of the parties to the lease but also those of third parties. If a transaction creates a lease and not a security interest, the lessee's interest in the goods is limited to its leasehold estate; the residual interest in the goods belongs to the lessor. This has significant implications to the lessee's creditors. "On common law theory, the lessor, since he has not parted with title, is entitled to full protection against the lessee's creditors and trustee in bankruptcy" 1 G. Gilmore, *Security Interests in Personal Property* § 3.6, at 76 (1965).

Under pre-Act chattel security law there was generally no requirement that the lessor file the lease, a financing statement, or the like, to enforce the lease agreement against the lessee or any third party; the Article on Secured Transactions (Article 9) did not change the common law in that respect. Coogan, *Leasing and the Uniform Commercial Code*, in *Equipment Leasing-Leveraged Leasing* 681, 700 n.25, 729 n.80 (2d ed.1980). The Article on Leases (Article 2A) has not changed the law in that respect, except for leases of fixtures. Section 2A-309. An examination of the common law will not provide an adequate answer to the question of what is a lease. The definition of security interest in Section 1-201(37) of the 1978 Official Text of the Act provides that the Article on Secured Transactions (Article 9) governs security interests disguised as leases, *i.e.*, leases intended as security; however, the definition is vague and outmoded.

Lease is defined in Article 2A as a transfer of the right to possession and use of goods for a term, in return for consideration. Section 2A-103(1)(j). The definition continues by stating that the retention or creation of a security interest is not a lease. Thus, the task of sharpening the line between true leases and security interests disguised as leases continues to be a function of this section.

The first paragraph of this definition is a revised version of the first five sentences of the 1978 Official Text of Section 1-201(37). The changes are modest in that they make a style change in the fourth sentence and delete the reference to lease in the fifth sentence. The balance of this definition is new, although it preserves elements of the last two sentences of the prior definition. The focus of the changes was to draw a sharper line between leases and security interests disguised as leases to create greater certainty in commercial transactions.

Prior to this amendment, Section 1-201(37) provided that whether a lease was intended as security (*i.e.*, a security interest disguised as a lease) was to be

determined from the facts of each case; however, (a) the inclusion of an option to purchase did not itself make the lease one intended for security, and (b) an agreement that upon compliance with the terms of the lease the lessee would become, or had the option to become, the owner of the property for no additional consideration, or for a nominal consideration, did make the lease one intended for security.

Reference to the intent of the parties to create a lease or security interest has led to unfortunate results. In discovering intent, courts have relied upon factors that were thought to be more consistent with sales or loans than leases. Most of these criteria, however, are as applicable to true leases as to security interests. Examples include the typical net lease provisions, a purported lessor's lack of storage facilities or its character as a financing party rather than a dealer in goods. Accordingly, amended Section 1-201(37) deletes all reference to the parties' intent.

The second paragraph of the new definition is taken from Section 1(2) of the Uniform Conditional Sales Act (act withdrawn 1943), modified to reflect current leasing practice. Thus, reference to the case law prior to this Act will provide a useful source of precedent. Gilmore, *Security Law, Formalism and Article 9*, 47 Neb.L.Rev. 659, 671 (1968). Whether a transaction creates a lease or a security interest continues to be determined by the facts of each case. The second paragraph further provides that a transaction creates a security interest if the lessee has an obligation to continue paying consideration for the term of the lease, if the obligation is not terminable by the lessee (thus correcting early statutory gloss, e.g., *In re Royer's Bakery, Inc.*, 1 U.C.C. Rep.Serv. (Callaghan) 342 (Bankr.E.D.Pa.1963)) and if one of four additional tests is met. The first of these four tests, subparagraph (a), is that the original lease term is equal to or greater than the remaining economic life of the goods. The second of these tests, subparagraph (b), is that the lessee is either bound to renew the lease for the remaining economic life of the goods or to become the owner of the goods. *In re Gehrke Enters.*, 1 Bankr. 647, 651-52 (Bankr.W.D.Wis.1979). The third of these tests, subparagraph (c), is whether the lessee has an option to renew the lease for the remaining economic life or the goods for no additional consideration or for nominal additional consideration, which is defined later in this section. *In re Celeryvale Transp.*, 44 Bankr. 1007, 1014-15 (Bankr.E.D.Tenn.1984). The fourth of these tests, subparagraph (d), is whether the lessee has an option to become the owner of the goods for no additional consideration or for nominal additional consideration. All of these tests focus on economics, not the intent of the parties. *In re Berge*, 32 Bankr. 370, 371-73 (Bankr.W.D.Wis.1983).

The focus on economics is reinforced by the next paragraph, which is new. It states that a transaction does not create a security interest merely because the transaction has certain characteristics listed therein. Subparagraph (a) has no statutory derivative; it states that a full payout lease does not *per se* create a security interest. *Rushton v. Shea*, 419 F.Supp. 1349, 1365 (D.Del.1976). Subparagraph (b) provides the same regarding the provisions of the typical net lease. *Compare All-States Leasing Co. v. Ochs*, 42 Or.App. 319, 600 P.2d 899

(Ct.App.1979) with *In re Tillery*, 571 F.2d 1361 (5th Cir.1978). Subparagraph (c) restates and expands the provisions of former Section 1-201(37) to make clear that the option can be to buy or renew. Subparagraphs (d) and (e) treat fixed price options and provide that fair market value must be determined at the time the transaction is entered into. Compare *Arnold Mach. Co. v. Balls*, 624 P.2d 678 (Utah 1981) with *Aoki v. Shepherd Mach. Co.*, 665 F.2d 941 (9th Cir.1982).

The relationship of the second paragraph of this subsection to the third paragraph of this subsection deserves to be explored. The fixed price purchase option provides a useful example. A fixed price purchase option in a lease does not of itself create a security interest. This is particularly true if the fixed price is equal to or greater than the reasonably predictable fair market value of the goods at the time the option is to be performed. A security interest is created only if the option price is nominal and the conditions stated in the introduction to the second paragraph of this subsection are met. There is a set of purchase options whose fixed price is less than fair market value but greater than nominal that must be determined on the facts of each case to ascertain whether the transaction in which the option is included creates a lease or a security interest.

It was possible to provide for various other permutations and combinations with respect to options to purchase and renew. For example, this section could have stated a rule to govern the facts of *In re Marhoefer Packing Co.*, 674 F.2d 1139 (7th Cir.1982). This was not done because it would unnecessarily complicate the definition. Further development of this rule is left to the courts.

The fourth paragraph provides definitions and rules of construction.

38. "Send". New. Compare "notifies".

39. "Signed". New. The inclusion of authentication in the definition of "signed" is to make clear that as the term is used in this Act a complete signature is not necessary. Authentication may be printed, stamped or written; it may be by initials or by thumbprint. It may be on any part of the document and in appropriate cases may be found in a billhead or letterhead. No catalog of possible authentications can be complete and the court must use common sense and commercial experience in passing upon these matters. The question always is whether the symbol was executed or adopted by the party with present intention to authenticate the writing.

40. "Surety". New.

41. "Telegram". New.

42. "Term". New.

43. Under the former version of § 1-201(43), it was not clear whether a reference to an "unauthorized signature" in Articles 3 and 4 applied to indorsements. The words "or indorsement" are deleted so that references to "unauthorized signature" in § 3-406 and elsewhere will unambiguously refer to any signature.

44. “Value”. See Sections 25, 26, 27, 191, Uniform Negotiable Instruments Law; Section 76, Uniform Sales Act; Section 53, Uniform Bills of Lading Act; Section 58, Uniform Warehouse Receipts Act; Section 22(1), Uniform Stock Transfer Act; Section 1, Uniform Trust Receipts Act. All the Uniform Acts in the commercial law field (except the Uniform Conditional Sales Act) have carried definitions of “value”. All those definitions provided that value was any consideration sufficient to support a simple contract, including the taking of property in satisfaction of or as security for a pre-existing claim. Subsections (a), (b) and (d) in substance continue the definitions of “value” in the earlier acts. Subsection (c) makes explicit that “value” is also given in a third situation: where a buyer by taking delivery under a pre-existing contract converts a contingent into a fixed obligation.

This definition is not applicable to Articles 3 and 4, but the express inclusion of immediately available credit as value follows the separate definitions in those Articles. See Sections 4-208, 4-209, 3-303. A bank or other financing agency which in good faith makes advances against property held as collateral becomes a bona fide purchaser of that property even though provision may be made for charge-back in case of trouble. Checking credit is “immediately available” within the meaning of this section if the bank would be subject to an action for slander of credit in case checks drawn against the credit were dishonored, and when a charge-back is not discretionary with the bank, but may only be made when difficulties in collection arise in connection with the specific transaction involved.

45. “Warehouse receipt”. See Section 76(1), Uniform Sales Act; Section 1, Uniform Warehouse Receipts Act. Receipts issued by a field warehouse are included, provided the warehouseman and the depositor of the goods are different persons.

46. “Written” or “writing”. This is a broadening of the definition contained in Section 191 of the Uniform Negotiable Instruments Law.

Official Comment § 1-202

Prior Uniform Statutory Provision:

None.

Purposes:

1. This section is designed to supply judicial recognition for documents which have traditionally been relied upon as trustworthy by commercial men.
2. This section is concerned only with documents which have been given a preferred status by the parties themselves who have required their procurement in the agreement and for this reason the applicability of the section is limited to actions arising out of the contract which authorized or required the document. The documents listed are intended to be illustrative and not all inclusive.

3. The provisions of this section go no further than establishing the documents in question as prima facie evidence and leave to the court the ultimate determination of the facts where the accuracy or authenticity of the documents is questioned. In this connection the section calls for a commercially reasonable interpretation.

Definitional Cross References:

“Bill of lading”. Section 1-201.

“Contract”. Section 1-201.

“Genuine”. Section 1-201.

Official Comment § 1-203

Prior Uniform Statutory Provision:

None.

Purposes:

This section sets forth a basic principle running throughout this Act. The principle involved is that in commercial transactions good faith is required in the performance and enforcement of all agreements or duties. Particular applications of this general principle appear in specific provisions of the Act such as the option to accelerate at will (Section 1-208), the right to cure a defective delivery of goods (Section 2-508), the duty of a merchant buyer who has rejected goods to effect salvage operations (Section 2-603), substituted performance (Section 2-614), and failure of presupposed conditions (Section 2-615). The concept, however, is broader than any of these illustrations and applies generally, as stated in this section, to the performance or enforcement of every contract or duty within this Act. It is further implemented by Section 1-205 on course of dealing and usage of trade. This section does not support an independent cause of action for failure to perform or enforce in good faith. Rather, this section means that a failure to perform or enforce, in good faith, a specific duty or obligation under the contract, constitutes a breach of that contract or makes unavailable, under the particular circumstances, a remedial right or power. This distinction makes it clear that the doctrine of good faith merely directs a court towards interpreting contracts within the commercial context in which they are created, performed, and enforced, and does not create a separate duty of fairness and reasonableness which can be independently breached. See PEB Commentary No. 10, dated February 10, 1994.

It is to be noted that under the Sales Article definition of good faith (Section 2-103), contracts made by a merchant have incorporated in them the explicit standard not only of honesty in fact (Section 1-201), but also of observance by the merchant of reasonable commercial standards of fair dealing in the trade.

Cross References:

Sections 1-201; 1-205; 1-208; 2-103; 2-508; 2-603; 2-614; 2-615.

Definitional Cross References:

“Contract”. Section 1-201.

“Good faith”. Section 1-201; 2-103.

Official Comment § 1-204

Prior Uniform Statutory Provision:

Compare Section 193, Uniform Negotiable Instruments Law.

Purposes:

1. Subsection (1) recognizes that nothing is stronger evidence of a reasonable time than the fixing of such time by a fair agreement between the parties. However, provision is made for disregarding a clause which whether by inadvertence or overreaching fixes a time so unreasonable that it amounts to eliminating all remedy under the contract. The parties are not required to fix the most reasonable time but may fix any time which is not obviously unfair as judged by the time of contracting.

2. Under the section, the agreement which fixes the time need not be part of the main agreement, but may occur separately. notice also that under the definition of “agreement” (Section 1-201) the circumstances of the transaction, including course of dealing or usages of trade or course of performance may be material. On the question what is a reasonable time these matters will often be important.

Definitional Cross Reference:

“Agreement”. Section 1-201.

Official Comment § 1-205

Prior Uniform Statutory Provision:

No such general provision but see Sections 9(1), 15(5), 18(2), and 71, Uniform Sales Act.

Purposes:

This section makes it clear that:

1. This Act rejects both the “lay-dictionary” and the “conveyancer’s” reading of a commercial agreement. Instead the meaning of the agreement of the parties is to be determined by the language used by them and by their action, read and interpreted in the light of commercial practices and other surrounding circumstances. The measure and background for interpretation are set by the commercial context, which may explain and supplement even the language of a

formal or final writing.

2. Course of dealing under subsection (1) is restricted, literally, to a sequence of conduct between the parties previous to the agreement. However, the provisions of the Act on course of performance make it clear that a sequence of conduct after or under the agreement may have equivalent meaning. (Section 2-208.)

3. "Course of dealing" may enter the agreement either by explicit provisions of the agreement or by tacit recognition.

4. This Act deals with "usage of trade" as a factor in reaching the commercial meaning of the agreement which the parties have made. The language used is to be interpreted as meaning what it may fairly be expected to mean to parties involved in the particular commercial transaction in a given locality or in a given vocation or trade. By adopting in this context the term "usage of trade" this Act expresses its intent to reject those cases which see evidence of "custom" as representing an effort to displace or negate "established rules of law". A distinction is to be drawn between mandatory rules of law such as the Statute of Frauds provisions of Article 2 on Sales whose very office is to control and restrict the actions of the parties, and which cannot be abrogated by agreement, or by a usage of trade, and those rules of law (such as those in Part 3 of Article 2 on Sales) which fill in points which the parties have not considered and in fact agreed upon. The latter rules hold "unless otherwise agreed" but yield to the contrary agreement of the parties. Part of the agreement of the parties to which such rules yield is to be sought for in the usages of trade which furnish the background and give particular meaning to the language used, and are the framework of common understanding controlling any general rules of law which hold only when there is no such understanding.

5. A usage of trade under subsection (2) must have the "regularity of observance" specified. The ancient English tests for "custom" are abandoned in this connection. Therefore, it is not required that a usage of trade be "ancient or immemorial", "universal" or the like. Under the requirement of subsection (2) full recognition is thus available for new usages and for usages currently observed by the great majority of decent dealers, even though dissidents ready to cut corners do not agree. There is room also for proper recognition of usage agreed upon by merchants in trade codes.

6. The policy of this Act controlling explicit unconscionable contracts and clauses (Sections 1-203, 2-302) applies to implicit clauses which rest on usage of trade and carries forward the policy underlying the ancient requirement that a custom or usage must be "reasonable". However, the emphasis is shifted. The very fact of commercial acceptance makes out a prima facie case that the usage is reasonable, and the burden is no longer on the usage to establish itself as being reasonable. But the anciently established policing of usage by the courts is continued to the extent necessary to cope with the situation arising if an unconscionable or dishonest practice should become standard.

7. Subsection (3), giving the prescribed effect to usages of which the parties "are

or should be aware”, reinforces the provision of subsection (2) requiring not universality but only the described “regularity of observance” of the practice or method. This subsection also reinforces the point of subsection (2) that such usages may be either general to trade or particular to a special branch of trade.

8. Although the terms in which this Act defines “agreement” include the elements of course of dealing and usage of trade, the fact that express reference is made in some sections to those elements is not to be construed as carrying a contrary intent or implication elsewhere. Compare Section 1-102(4).

9. In cases of a well established line of usage varying from the general rules of this Act where the precise amount of the variation has not been worked out into a single standard, the party relying on the usage is entitled, in any event, to the minimum variation demonstrated. The whole is not to be disregarded because no particular line of detail has been established. In case a dominant pattern has been fairly evidenced, the party relying on the usage is entitled under this section to go to the trier of fact on the question of whether such dominant pattern has been incorporated into the agreement.

10. Subsection (6) is intended to insure that this Act’s liberal recognition of the needs of commerce in regard to usage of trade shall not be made into an instrument of abuse.

Cross References:

Point 1: Sections 1-203, 2-104 and 2-202.

Point 2: Section 2-208.

Point 4: Section 2-201 and Part 3 of Article 2.

Point 6: Sections 1-203 and 2-302.

Point 8: Sections 1-102 and 1-201.

Point 9: Section 2-204(3).

Definitional Cross References:

“Agreement”. Section 1-201.

“Contract”. Section 1-201.

“Party”. Section 1-201.

“Term”. Section 1-201.

Official Comment § 1-206

Prior Uniform Statutory Provision:

Section 4, Uniform Sales Act (which was based on Section 17 of the Statute of 29

Charles II).

Changes:

Completely rewritten by this and other sections.

Purposes:

To fill the gap left by the Statute of Frauds provisions for goods (Section 2-201), securities (Section 8-319), and security interests (Section 9-203). The Uniform Sales Act covered the sale of “choses in action”; the principal gap relates to sale of the “general intangibles” defined in Article 9 (Section 9-106) and to transactions which the buyer’s remedies for defect survive acceptance without being expressly claimed if notice of the defects is given within a reasonable time. Nor does it disturb the policy of those cases which restrict the effect of a waiver of a defect to reasonable limits under the circumstances, even though no such reservation is expressed.

The section is not addressed to the creation or loss of remedies in the ordinary course of performance but rather to a method of procedure where one party is claiming as of right something which the other believes to be unwarranted.

3. Judicial authority was divided on the issue of whether former Section 1-207 (present subsection (1)) applied to an accord and satisfaction. Typically the cases involved attempts to reach an accord and satisfaction by use of a check tendered in full satisfaction of a claim. Subsection (2) of revised Section 1-207 resolves this conflict by stating that Section 1-207 does not apply to an accord and satisfaction. Section 3-311 of revised Article 3 governs if an accord and satisfaction is attempted by tender of a negotiable instrument as stated in that section. If Section 3-311 does not apply, the issue of whether an accord and satisfaction has been effected is determined by the law of contract. Whether or not Section 3-311 applies, Section 1-207 has no application to an accord and satisfaction.

Official Comment § 1-207

Prior Uniform Statutory Provision:

None.

Purposes:

1. This section provides machinery for the continuation of performance along the lines contemplated by the contract despite a pending dispute, by adopting the mercantile device of going ahead with delivery, acceptance, or payment “without prejudice,” “under protest,” “under reserve,” “with reservation of our rights,” and the like. All of these phrases completely reserve all rights within the meaning of this section. The section therefore contemplates that limited as well as general reservations and acceptance by a party may be made “subject to satisfaction of

our purchaser,” “subject to acceptance by our customers,” or the like.

2. This section does not add any new requirement of language of reservation where not already required by law, but merely provides a specific measure on which a party can rely as he makes or concurs in any interim adjustment in the course of performance. It does not affect or impair the provisions of this Act such as those under which the buyer’s remedies for defect survive acceptance without being expressly claimed if notice of the defects is given within a reasonable time. Nor does it disturb the policy of those cases which restrict the effect of a waiver of a defect to reasonable limits under the circumstances, even though no such reservation is expressed.

The section is not addressed to the creation or loss of remedies in the ordinary course of performance but rather to a method of procedure where one party is claiming as of right something which the other feels to be unwarranted.

3. Judicial authority was divided on the issue of whether former Section 1-207 (present subsection (1)) applied to an accord and satisfaction. Typically the cases involved attempts to reach an accord and satisfaction by use of a check tendered in full satisfaction of a claim. Subsection (2) of revised Section 1-207 resolves this conflict by stating that Section 1-207 does not apply to an accord and satisfaction. Section 3-311 of revised Article 3 governs if an accord and satisfaction is attempted by tender of a negotiable instrument as stated in that section. If Section 3-311 does not apply, the issue of whether an accord and satisfaction has been effected is determined by the law of contract. Whether or not Section 3-311 applies, Section 1-207 has no application to an accord and satisfaction.

Cross References:

Section 2-607

Definitional Cross References:

“Party”. Section 1-201.

“Rights”. Section 1-201.

Official Comment § 1-208

Prior Uniform Statutory Provision:

None.

Purposes:

The increased use of acceleration clauses either in the case of sales on credit or in time paper or in security transactions has led to some confusion in the cases as to the effect to be given to a clause which seemingly grants the power of an acceleration at the whim and caprice of one party. This Section is intended to

make clear that despite language which can be so construed and which further might be held to make the agreement void as against public policy or to make the contract illusory or too indefinite for enforcement, the clause means that the option is to be exercised only in the good faith belief that the prospect of payment or performance is impaired.

Obviously this section has no application to demand instruments or obligations whose very nature permits call at any time with or without reason. This section applies only to an agreement or to paper which in the first instance is payable at a future date.

Definitional Cross References:

“Burden of establishing”. Section 1-201.

“Good faith”. Section 1-201.

“Party”. Section 1-201.

“Term”. Section 1-201.

Official Comment § 1-209

Source:

New York.

Prior Uniform Statutory Provision:

None.

Reason for Change:

The drafting history of Article 9 makes it clear that there was no intention to cover agreements by which the rights of one unsecured creditor are subordinated to the rights of another unsecured creditor of a common debtor. Nevertheless, since in insolvency proceedings dividends otherwise payable to a subordinated creditor are turned over to the superior creditor, fears have been expressed that a subordination agreement might be treated as a “security agreement” creating a “security interest” in property of the subordinated creditor, and that inappropriate provisions of Article 9 might be applied. This optional section is intended to allay such fears by making an explicit declaration that a subordination agreement does not of itself create a security interest. Nothing in this section prevents the creation of a security interest in such a case when the parties to the agreement so intend.

Purposes:

1. Billions of dollars of subordinated debt are held by the public and by institutional investors. Commonly, the subordinated debt is subordinated on issue or acquisition and is evidenced by an investment security or by a negotiable or non-negotiable note. Debt is also sometimes subordinated after it arises, either by

agreement between the subordinating creditor and the debtor, by agreement between two creditors of the same debtor, or by agreement of all three parties. The subordinated creditor may be a stockholder or other “insider” interested in the common debtor; the subordinated debt may consist of accounts or other rights to payment not evidenced by any instrument. All such cases are included in the terms “subordinated obligation,” “subordination,” and “subordinated creditor.”

2. Subordination agreements are enforceable between the parties as contracts; and in the bankruptcy of the common debtor dividends otherwise payable to the subordinated creditor are turned over to the superior creditor. This “turn-over” practice has on occasion been explained in terms of “equitable lien,” “equitable assignment,” or “constructive trust,” but whatever the label the practice is essentially an equitable remedy and does not mean that there is a transaction “intended to create a security interest,” a “sale of accounts, contract rights or chattel paper,” or a “security interest created by contract,” within the meaning of Section 9-102. On the other hand, nothing in this section prevents one creditor from assigning his rights to another creditor of the same debtor in such a way as to create a security interest within Article 9, where the parties so intend.

3. The last sentence of this section is intended to negate any implication that the section changes the law. It is intended to be declaratory of pre-existing law. Both the history and the text of Article 9 make it clear that it was not intended to cover subordination agreements. The provisions of Section 9-203 for signature by the “debtor” would be entirely unworkable if read to require signature by public holders of subordinated investment securities. The priorities, filing provisions and remedies on default provided by Article 9 would also be largely inappropriate in many situations. The precautionary language of Section 9-316 preserving subordination of priority by agreement between secured parties points to the conclusion that similar arrangements among unsecured lenders are not covered unless otherwise within the scope of the Article.

4. The enforcement of subordination agreements is largely left to supplementary principles under Section 1-103. If the subordinated debt is evidenced by an investment security, Section 8-202(1) authorizes enforcement against purchasers on terms stated or referred to on the security. If the fact of subordination is noted on a negotiable instrument, a holder under Sections 3-302 and 3-306 is subject to the term because notice precludes him from taking free of the subordination. Sections 3-302(3)(a), 3-306 and 8-317 severely limit the rights of levying creditors of a subordinated creditor in such cases.

Definitional Cross References:

“Agreement”. Section 1-201.

“Creditor”. Section 1-201.

“Debtor”. Section 9-105.

“Person”. Section 1-201.

“Rights”. Section 1-201.

“Security interest”. Section 1-201.

General Comment

This Comment covers the development of the Code prior to 1962. Its subsequent history leading to the 1962, 1966, 1972, 1977 and 1987 Official Text and Comment changes is contained in Reports and Forewords of the Permanent Editorial Board for the Uniform Commercial Code.

Uniformity throughout American jurisdictions is one of the main objectives of this Code; and that objective cannot be obtained without substantial uniformity of construction. To aid in uniform construction of this Comment and those which follow the text of each section set forth the purpose of various provisions of this Act to promote uniformity, to aid in viewing the Act as an integrated whole, and to safeguard against misconstruction.

This Act is a revision of the original Uniform Commercial Code promulgated in 1951 and enacted in Pennsylvania in 1953, effective July 1, 1954; and these Comments are a revision of the original comments, which were before the Pennsylvania legislature at the time of its adoption of the Code. Changes from the text enacted in Pennsylvania in 1953 are clearly legitimate legislative history, but without explanation such changes may be misleading, since frequently matters have been omitted as being implicit without statement and language has been changed or added solely for clarity. Accordingly, the changes from the original text were published, under the title “1956 Recommendations of the Editorial Board for the Uniform Commercial Code,” early in 1957, with reasons, and revised Comments were then prepared to restate the statutory purpose in the light of the revision of text.

The subsequent history leading to the 1962 Official Text with Comments is set out in detail in Report No. 1 of the Permanent Editorial Board for the Uniform Commercial Code.

Hitherto most commercial transactions have been regulated by a number of Uniform Laws prepared and promulgated by the National Conference of Commissioners on Uniform State Laws. These acts, with the dates of their promulgation by the Conference, are:

Uniform Negotiable Instruments Law1896

Uniform Warehouse Receipts Act.....1906

Uniform Sales Act1906

Uniform Bills of Lading Act.....1909

Uniform Stock Transfer Act.....1909

Uniform Conditional Sales Act.....1918

Uniform Trust Receipts Act.....1933

Two of these acts were adopted in every American State and the remaining acts have had wide acceptance. Each of them has become a segment of the statutory law relating to commercial transactions. It has been recognized for some years that these acts needed substantial revision to keep them in step with modern commercial practices and to integrate each of them with the others.

The concept of the present Act is that “commercial transactions” is a single subject of the law, notwithstanding its many facets.

A single transaction may very well involve a contract for sale, followed by a sale, the giving of a check or draft for a part of the purchase price, and the acceptance of some form of security for the balance.

The check or draft may be negotiated and will ultimately pass through one or more banks for collection.

If the goods are shipped or stored the subject matter of the sale may be covered by a bill of lading or warehouse receipt or both.

Or it may be that the entire transaction was made pursuant to a letter of credit either domestic or foreign.

Obviously, every phase of commerce involved is but a part of one transaction, namely, the sale of and payment for goods.

If, instead of goods in the ordinary sense, the transaction involved stocks or bonds, some of the phases of the transaction would obviously be different. Others would be the same. In addition, there are certain additional formalities incident to the transfer of stocks and bonds from one owner to another.

This Act purports to deal with all the phases which may ordinarily arise in the handling of a commercial transaction, from start to finish.

Because of the close relationship of each phase of a complete transaction to every other phase, it is believed that each Article of this Act is cognate to the single broad subject “Commercial Transactions”, and that this Act is valid under any constitutional provision requiring an act to deal with only one subject. See, for excellent discussions of the meaning of “single subject”: *House v. Creveling*, 147 Tenn. 589, 250 S.W. 357 (1923) and *Commonwealth v. Snyder*, 279 Pa. 234, 123 A. 792 (1924).

The preparation of the Act (which Section 1-101 denominates the “Uniform Commercial Code”) was begun as a joint project of The American Law Institute and the National Conference of Commissioners on Uniform State Laws in 1942. Various drafts were considered by joint committees of both bodies and debated by the full membership of each organization at annual meetings.

In the main, the project was made possible, financially, through a large grant by The Maurice and Laura Falk Foundation of Pittsburgh, Pennsylvania, supplemented by

contributions from the Beaumont Foundation of Cleveland, Ohio, and from 98 business and financial concerns and law firms. Additional funds for final revisions and study were received from the Falk Foundation and others.

The original drafting and editorial work which led to the 1952 edition of the Code was in charge of an Editorial Board of which United States Circuit Judge Herbert F. Goodrich of Philadelphia was Chairman. The other members at various times were Professor Karl N. Llewellyn of the University of Chicago Law School, Walter D. Malcolm, Esquire, of Boston, John C. Pryor, Esquire, of Burlington, Iowa, Wm. A. Schnader, Esquire, of Philadelphia, and Harrison Tweed, Esquire, of New York City. In the final stages of work on the Code, certain questions of policy were submitted for consideration to an Enlarged Editorial Board consisting at various times of the foregoing members and Howard L. Barkdull, Esquire, of Cleveland, Joe C. Barrett, Esquire, of Jonesboro, Arkansas, Robert K. Bell, Esquire, of Ocean City, N.J., Robert P. Goldman, Esquire, of Cincinnati, Dean Albert J. Harno of the University of Illinois Law School, Ben W. Heineman, Esquire, of Chicago, Carlos Israels, Esquire, of New York City, Albert E. Jenner, Esquire, of Chicago, Arthur Littleton, Esquire, of Philadelphia, Willard B. Luther, Esquire, of Boston, Kurt F. Pantzer, Esquire, of Indianapolis, Indiana, George Richter, Jr., Esquire, of Los Angeles, R. Jasper Smith, Esquire, of Springfield, Missouri, United States Circuit Judge Sterry Waterman of St. Johnsbury, Vermont, and Charles H. Willard, Esquire, of New York City.

The Chief Reporter of the Code was Professor Llewellyn, and the Associate Chief Reporter was Professor Soia Mentschikoff. Final editorial preparation of the 1952 edition was in the hands of Professor Charles Bunn of the University of Wisconsin Law School. The Coordinators for the revisions leading to this 1962 edition were Professors Robert Braucher and A.E. Sutherland of the Law School of Harvard University, Professor Braucher doing the final editorial preparation for this edition.

The actual drafting was done in some cases by practicing lawyers and in others by teachers of various law schools. The customary procedure required that before a draft was submitted for discussion to the general memberships of The American Law Institute and of the National Conference of Commissioners, it was successively approved by three groups.

The first group were the so-called "advisers", consisting of specially selected judges, practicing lawyers and law teachers. The advisers met with the draftsmen on frequent occasions to debate and iron out, not only the substance but the form and phraseology of the proposed draft.

After the draft was cleared by the advisers, it was meticulously examined by the next two groups-the Council of The American Law Institute and either the Commercial Acts Section or the Property Acts Section of the Conference of Commissioners.

When these bodies had given their approval to the draft, it came before the general membership both of the Institute and of the Conference for consideration.

In addition in the final stages leading to this 1962 edition each article was reviewed and discussed by a special Subcommittee for that article. Recommendations of the

Subcommittee were reviewed and acted upon by the Enlarged Editorial Board, pursuant to authority from the sponsoring bodies.

The judges, practicing lawyers and law teachers who originally acted either as advisers or as draftsmen were:

Judges: John T. Loughran, of the New York Court of Appeals; Thomas W. Swan, United States Circuit Judge for the Second Circuit; and the late John D. Wickhem, of the Supreme Court of Wisconsin.

Practicing lawyers: Dana C. Backus, of New York, N.Y.; Howard L. Barkdull, of Cleveland, Ohio; Lawrence G. Bennett, of New York, N.Y.; Harold F. Birnbaum, of Los Angeles, California; William L. Eagleton, of Washington, D.C.; H. Vernon Eney, of Baltimore, Maryland; Fairfax Leary, Jr., of Philadelphia, Pennsylvania; Willard B. Luther, of Boston, Massachusetts; Walter D. Malcolm, of Boston, Massachusetts; Frederic M. Miller, of Des Moines, Iowa; Hiram Thomas, of New York, N.Y.; Sterry R. Waterman, of St. Johnsbury, Vermont; and Cornelius W. Wickersham, of New York, N.Y.

The law teachers were: Ralph J. Baker, of the Harvard Law School; William E. Britton, of the University of Illinois Law School; Charles Bunn, of the University of Wisconsin Law School; Arthur L. Corbin, of Yale University Law School; Allison Dunham, of Columbia University Law School; Grant Gilmore, of Yale University Law School; Albert J. Harno, of the University of Illinois Law School; Friedrich Kessler, of the Yale University Law School; Maurice H. Merrill, of the University of Oklahoma Law School; William L. Prosser, of the University of California School of Law; Louis B. Schwartz, of the University of Pennsylvania Law School; and Bruce Townsend, of the University of Indiana Law School.

The members of the Council of the Institute during the period when the Commercial Code was under consideration were: Dillon Anderson, of Houston, Texas; Fletcher R. Andrews of Cleveland Heights, Ohio; the late Walter P. Armstrong of Memphis, Tennessee; Francis M. Bird, of Atlanta, Georgia; John G. Buchanan, of Pittsburgh, Pennsylvania; Charles Bunn, of Madison, Wisconsin; Howard F. Burns, of Cleveland, Ohio; Herbert W. Clark, of San Francisco, California; R. Ammi Cutter, of Boston, Massachusetts; Norris Darrell, of New York, N.Y.; the late John W. Davis, of New York, N.Y.; Edwin D. Dickinson, of Berkeley, California; Edward J. Dimock, of New York, N.Y.; Arthur Dixon, of Chicago, Illinois; Robert G. Dodge, of Boston, Massachusetts; the late George Donworth, of Seattle, Washington; Charles E. Dunbar, Jr., of New Orleans, Louisiana; William Dean Embree, of New York, N.Y.; Frederick F. Faville, of Des Moines, Iowa; James Alger Fee, of Portland, Oregon; Gerald F. Flood, of Philadelphia, Pennsylvania; H. Eastman Hackney, of Pittsburgh, Pennsylvania; the late Augustus N. Hand, of New York, N.Y.; Learned Hand, of New York, N.Y.; Albert J. Harno, of Urbana, Illinois; the late Earl G. Harrison, of Philadelphia, Pennsylvania; William V. Hodges, of New York, N.Y.; Joseph C. Hutcheson, Jr., of Houston, Texas; Laurence M. Hyde, of Jefferson City, Missouri; William J. Jameson, of Billings, Montana; Joseph F. Johnston, of Birmingham, Alabama; the late William H. Keller, of Lancaster, Pennsylvania; the late Daniel N. Kirby, of St. Louis, Missouri; Monte M.

Lemann, of New Orleans, Louisiana; the late William Draper Lewis, of Philadelphia, Pennsylvania; the late Henry T. Lummus, of Swampscott, Massachusetts; William L. Marbury, of Baltimore, Maryland; Robert N. Miller, of Washington, D.C.; the late William D. Mitchell, of New York, N.Y.; John J. Parker, of Charlotte, North Carolina; Thomas I. Parkinson, of New York, N.Y.; George Wharton Pepper, of Philadelphia, Pennsylvania; Timothy N. Pfeiffer, of New York, N.Y.; Ori L. Phillips, of Denver, Colorado; Frederick D.G. Ribble, of Charlottesville, Virginia; William A. Schnader, of Philadelphia, Pennsylvania; Bernard G. Segal, of Philadelphia, Pennsylvania; Austin W. Scott, of Cambridge, Massachusetts; the late Harry Shulman, of New Haven, Connecticut; Henry Upson Sims, of Birmingham, Alabama; the late Sydney Smith, of Jackson, Mississippi; Eugene B. Strassburger, of Pittsburgh, Pennsylvania; Thomas W. Swan, of Guilford, Connecticut; the late Thomas Day Thacher, of New York, N.Y.; Floyd E. Thompson, of Chicago, Illinois; the late Edgar Bronson Tolman, of Chicago, Illinois; the late Robert B. Tunstall, of Norfolk, Virginia; the late Arthur J. Tuttle, of Detroit, Michigan; Harrison Tweed, of New York, N.Y.; Cornelius W. Wickersham, of New York, N.Y.; the late John D. Wickhem, of Madison, Wisconsin; Raymond S. Wilkins, of Boston, Massachusetts; Charles H. Willard, of New York, N.Y.; Laurens Williams, of Washington, D.C.; Edward L. Wright, of Little Rock, Arkansas, and Charles E. Wyzanski, Jr., of Boston, Massachusetts.

The members of the Conference's Commercial Acts Section during the same period were: Howard L. Barkdull, of Cleveland, Ohio; the late William L. Beers, of New Haven, Connecticut; Charles R. Hardin, of Newark, New Jersey; Frank E. Horack, Jr., of Bloomington, Indiana; L. Barrett Jones, of Jackson, Mississippi; Karl N. Llewellyn, now of Chicago, Illinois; Willard B. Luther, of Boston, Massachusetts; William G. McLaren, of Seattle, Washington; Frederic M. Miller, of Des Moines, Iowa; William L. Prosser, of Berkeley, California; Arthur E. Sutherland, Jr., now of Cambridge, Massachusetts; O.H. Thormodsgard, of University, North Dakota; Sterry R. Waterman, of St. Johnsbury, Vermont; and Edward L. Wright, of Little Rock, Arkansas.

The members of the Conference's Property Acts Section during the period when it cooperated in the consideration of the Code were: Joe C. Barrett, of Jonesboro, Arkansas; the late William L. Beers, of New Haven, Connecticut; Boyd M. Benson, of Huron, South Dakota; George G. Bogert, now of San Francisco, California; C. Walter Cole, of Towson, Maryland; John A. Daly, of Boston, Massachusetts; William L. Eagleton, of Washington, D.C.; H. Vernon Eney, of Baltimore, Maryland; Spencer A. Gard, of Iola, Kansas; Homer B. Harris, of Lincoln, Illinois; W.J. Jameson, of Billings, Montana; the late Sherman R. Moulton, of Burlington, Vermont; J.C. Pryor, of Burlington, Iowa; the late C.M.A. Rogers, of Mobile, Alabama; Murray M. Shoemaker, of Cincinnati, Ohio; and Greenberry Simmons, of Louisville, Kentucky.

The members of the Subcommittees which considered the various articles of the Code in the work leading to the 1958 Edition were:

Article 1: Charles H. Willard, Esquire, Chairman, of New York, New York; Professor Charles Bunn of the University of Wisconsin Law School, Madison, Wisconsin; Mahlon E. Lewis, Esquire, of Pittsburgh, Pennsylvania.

Article 2: Professor Robert Braucher, Chairman, of the Law School of Harvard University, Cambridge, Massachusetts; Professor Karl N. Llewellyn, of the Law School of the University of Chicago, Chicago, Illinois; Bernard D. Broeker, Esquire, of Bethlehem, Pennsylvania; Frank T. Dierson, Esquire, of New York, New York.

Article 3: Professor A.E. Sutherland, Chairman, of the Law School of Harvard University, Cambridge, Massachusetts; William R. Emblidge, Esquire, of Buffalo, New York; John J. Clarke, Esquire, of the Federal Reserve Bank of New York, New York; James V. Vergari, Esquire, of Federal Reserve Bank of Philadelphia, Philadelphia, Pennsylvania.

Article 4: Walter D. Malcolm, Esquire, Chairman, of Boston, Massachusetts; James V. Vergari, Esquire; John J. Clarke, Esquire; Henry J. Bailey, III, Esquire, of the Federal Reserve Bank of New York, New York; Rollin C. Huggins, Esquire, of Chicago, Illinois; Carl W. Funk, Esquire, of Philadelphia, Pennsylvania.

Article 5: Arthur Littleton, Esquire, Chairman, Philadelphia, Pennsylvania; Mr. Horace M. Chadsey, Vice-President of the First National Bank of Boston; Arthur F. McCarthy, Esquire, of Philadelphia, Pennsylvania; Professor Soia Mentschikoff, of the University of Chicago Law School, Chicago, Illinois. In addition, the following acted as an Advisory Committee to the Article 5 Subcommittee: Ernest A. Carlson, of the Continental Illinois National Bank and Trust Company, Chicago, Illinois; John E. Corrigan, Jr., of the First National Bank of Chicago; Guy A. Crum, of the First National Bank of Chicago; Louis F. Dempsey, of the Northern Trust Company, Chicago, Illinois; Gerard E. Keidel, of the American National Bank and Trust Company of Chicago; Robert W. Maynard, of the Harris Trust and Savings Bank, Chicago, Illinois.

Article 6: Professor Charles Bunn, Chairman; Eugene B. Strassburger, Esquire, of Pittsburgh, Pennsylvania.

Article 7: Professor Robert Braucher, Chairman; John C. Pryor, Esquire, of Burlington, Iowa.

Article 8: Carlos Israels, Esquire, Chairman, of New York, New York; Professor Soia Mentschikoff; Eliot B. Thomas, Esquire, of Philadelphia, Pennsylvania; Fred B. Lund, Esquire, of Boston, Massachusetts.

Article 9: J. Francis Ireton, Esquire, Chairman, of Baltimore, Maryland; Homer L. Kripke, Esquire, of New York, New York; Anthony G. Felix, Jr., Esquire, of Philadelphia, Pennsylvania; Peter F. Coogan, Esquire, of Boston, Massachusetts; Professor Grant Gilmore, of Yale University Law School, New Haven, Connecticut; Harold F. Birnbaum, Esquire, of Los Angeles, California; Richard R. Winters, Esquire, of Pittsburgh, Pennsylvania; Professor John Hanna, of the Law School of Columbia University, New York, New York.

In addition there were informal consultants much too numerous to mention who frequently advised those working on the Code to insure a workable set of laws. In this latter class were included practicing lawyers, hard-headed businessmen and operating bankers, who contributed generously of their time and knowledge so that, not only

current business practice, but foreseeable future developments would be covered.

Committees of several Bar Associations, and in particular a committee of the Section of Corporation, banking and Business Law of the American Bar Association, of which Mr. Walter D. Malcolm of Boston was chairman, considered the various drafts of the Code and made valuable suggestions. After final approval of the Code by the Institute and the Conference, and in accordance with the practice of the Conference, the completed Code was submitted to the American Bar Association and was approved by the House of Delegates of that Association.

PERMANENT EDITORIAL BOARD COMMENTARY

PEB Commentary No. 10 (Section 1-203) (February 10, 1994)

Issue

Section 1-203 provides that “Every contract or duty within this Act imposes an obligation of good faith in its performance or enforcement.” [NOTE 1⁸] While this concept applies generally to every contract, it finds particular expression throughout the Code. For example, out of over 400 Code provisions, more than 50 sections make specific reference to “good faith.” [NOTE 2⁹]

The meaning of “good faith” varies with the context. Sometimes the context is as a standard of performance or enforcement; other times the context is that of good faith purchase. [NOTE 3¹⁰] This Commentary deals only with good faith performance or enforcement of a right or duty under a contract that is within the Code.

In the context in which the obligation of good faith functions as the standard of contract performance or enforcement, can the failure to meet this standard support a cause of action where no other basis for a cause of action exists? This Commentary examines this question in order to promote a uniform understanding of what it means to say that a general obligation of good faith is imposed on every contracting party. In so doing, several principles are discussed.

Discussion

1. *Good Faith, Commercial Expectations, and the Concept of Agreement*

Section 1-201(19) defines good faith as “honesty in fact in the conduct or transaction concerned.” [NOTE 4¹¹] Commentators have said that this general requirement of good faith sets a “subjective” standard, [¹² . . . [has] been historically construed as applying only to the actor’s subjective state of mind.”]; Braucher, *The Legislative History of the Uniform Commercial Code*, 58 Colum. L. Rev. 798, 812 (1958) (describing the test of good faith in § 1-201(19) as a “subjective” test, sometimes known as the rule of “the pure heart and empty head”); Lawrence, *The Prematurely Reported Demise of the Perfect Tender Rule*,

35 U. Kan. L. Rev. 557, 571 (1987) (“Good faith is a subjective term meaning ‘honesty in fact in the contract or transaction concerned.’”).**NOTE 5]** while the particularized definitions elsewhere also create an additional “objective” standard of the observance of reasonable commercial standards of fair dealing. This Commentary applies with equal force to both standards of good faith.

The principal author of the Code, Karl Llewellyn, recognized that parties develop expectations over time against the background of commercial practices and that if commercial law fails to account for those practices, it will cut against the parties’ actual expectations. In an unpublished commentary on the Proposed Final Draft of the Uniform Revised Sales Act, Llewellyn had this to say about good faith:

No inconsistency of language and background exists merely because the words used mean something different to an outsider than they do to the merchants who used that language in the light of the commercial background against which they contracted. This is the necessary result of applying commercial standards and principles of good faith to the agreement. . . . Moreover, where the commercial background normally gives to a term in question some breadth of meaning so that it describes a range of acceptable tolerances rather than a sharp-edged single line of action, any attempted narrowing of this meaning by one party is so unusual as not likely to be expected or perceived by the other. Therefore, attention must be called to a desire to contract at material variance from the accepted commercial pattern of contract or use of language. Thus, this Act rejects any “surprise” variation from the fair and normal meaning of the agreement. [**NOTE 6**¹³]

Explaining the doctrine of good faith in such terms is thus a recognition that, as expressed in the Code, it serves as a directive to protect the reasonable expectations of the contracting parties. The general imperative that the reasonable expectations of the parties are the measure of the good faith of each suggests that good faith is a concept with conceptual content related to that of agreement.

The Code definition of “Agreement” reads:

“Agreement” means the bargain of the parties in fact as found in their language or by implication from other circumstances including course of dealing or usage of trade or course of performance as provided in this Act (Sections 1-205 and 2-208). [**NOTE 7**¹⁴]

The agreement of the parties consists of more than their language alone. In elaborating on this theme, Comment 3 to § 1-201 emphasizes that “the word [agreement] is intended to include full recognition of usage of trade, course of dealing, *course of performance* and the surrounding circumstances as effective parts thereof. . . .” (emphasis added). [**NOTE 8**¹⁵]

“Course of dealing” is defined as follows:

A course of dealing is a sequence of previous conduct between the parties to a particular transaction which is fairly to be regarded as establishing a common

basis of understanding for interpreting their expressions and other conduct.
[¹⁶.NOTE 9]

“Usage of trade” is defined as follows:

A usage of trade is any practice or method of dealing having such regularity of observance in a place, vocation or trade as to justify an expectation that it will be observed with respect to the transaction in question. The existence and scope of such a usage are to be proved as facts. If it is established that such a usage is embodied in a written trade code or similar writing the interpretation of the writing is for the court. [¹⁷.NOTE 10]

“Course of performance” is defined as follows:

Where the contract for sale involves repeated occasions for performance by either party with knowledge of the nature of the performance and opportunity for objection to it by the other, any course of performance accepted or acquiesced in without objection shall be relevant to determine the meaning of the agreement. [NOTE 11¹⁸]

In addition to two definitional sections, § 1-205 contains two additional methodological sections which direct how express terms, course of dealing, and usage of trade are to be synthesized:

(3) A course of dealing between parties and any usage of trade in the vocation or trade in which they are engaged or of which they are or should be aware give particular meaning to and supplement or qualify terms of an agreement.

(4) The express terms of an agreement and an applicable course of dealing or usage of trade shall be construed wherever reasonable as consistent with each other; but when such construction is unreasonable express terms control both course of dealing and usage of trade and course of dealing controls usage of trade. [¹⁹-(4). The connection between § 1-205 and good faith is made explicit in the Comment to § 1-203, wherein it is stated that the obligation of good faith “is further implemented by Section 1-205 on course of dealing and usage of trade.”

The interpretational priorities set forth in § 1-205 are, with the added inclusion of course of performance, duplicated in § 2-208(2). That section states as follows:

The express terms of the agreement and any such course of performance, as well as any course of dealing and usage of trade, shall be construed whenever reasonable as consistent with each other; but when such construction is unreasonable, express terms shall control course of performance and course of performance shall control both course of dealing and usage of trade (Section 1-205)

See also UCC § 2A-207(2).NOTE 12]

At this juncture it is important to recognize that one acts in good faith relative to

the agreement of the parties. To decide the question whether a party has acted in good faith, a court must first ascertain the substance of the parties' agreement.

The performance and enforcement of agreements in a manner consistent with the reasonable expectations of the parties is in keeping with the broadest understanding of contract doctrine. [NOTE 13²⁰] The Code is consistent with this tradition of thought. However, the Code's concept of agreement broadens the sources for determining the meaning of the parties' agreement. The concept of agreement is not limited to the terms of the parties' writing: it includes a variety of elements, all of which must be synthesized.

Under § 1-205(4), the initial interpretive effort is to read all the terms as consistent with one another. Only when this is impossible does the interpreter then move to a lexical ordering of the terms, with express terms at the head of the list. Cases which make no attempt to reconcile the various terms before according priority to express terms in the construction of the parties' agreement must be considered to have proceeded improperly. [NOTE 14²¹] The better application of § 1-205(4), and the issues of interpretation which are central to it, is illustrated in cases like *Nanakuli Paving & Rock Co. v. Shell Oil Co.*, 664 F.2d 772, 32 UCC Rep. Serv. (Callaghan) 1025 (9th Cir. 1981) (upholding a finding that the written price term in an asphalt supply contract was qualified by a trade practice requiring suppliers to delay price increases for jobs on which buyers have already bid). Accordingly, in order to answer the question, "Has a party performed or enforced a contractual right or duty in good faith?", the content of the parties' agreement must first be determined. [NOTE 15²²]

2. UCC §1-203 Does Not Create an Independent Cause of Action

The inherent flaw in the view that § 1-203 supports an independent cause of action is the belief that the obligation of good faith has an existence which is conceptually separate from the underlying agreement. As the above discussion demonstrates, however, this is an incorrect view of the duty. "A party cannot simply 'act in good faith.' One acts in good faith relative to the agreement of the parties. Thus the real question is 'What is the Agreement of the parties?'" [23, there is an important methodological difference in that this Commentary requires, in the case of contracts within the Code, that the focus be upon the Agreement of the parties and their reasonable expectations. NOTE 16] Put differently, good faith merely directs attention to the parties' reasonable expectations; it is not an independent source from which rights and duties evolve. [NOTE 17²⁴] The language of § 1-203 itself makes this quite clear by providing that the obligation to perform or enforce in good faith extends only to the rights and duties resulting from the parties' contract. The term "contract" is, in turn, defined as "the total legal obligation which results from the parties' agreement...." [25 (emphasis supplied).NOTE 18] Consequently, resort to principles of law or equity outside the Code are not appropriate to create rights, duties, and liabilities inconsistent with those stated in the Code. [26.NOTE 19] For example, a breach of a contract or duty within the Code arising from a failure to act in good faith does not give rise to a claim for punitive damages unless specifically permitted. [27. NOTE 20]

Conclusion

Section 1-203 does not support a cause of action where no other basis for a cause of action exists.

The concept of Agreement permeates the entirety of the Code. For example, § 9-105(1)(l) incorporates the Article 1 concept of Agreement directly into Article 9. The “agreement of the parties” cannot be read off the face of a document, but must be discerned against the background of actual commercial practice. Not only does the Code recognize “the reasonable practices and standards of the commercial community . . . [as] an appropriate source of legal obligation,” [NOTE 21²⁸] but it also rejects the “premise that the language used [by the parties] has the meaning attributable to [it] by rules of construction existing in the law rather than the meaning which arises out of the commercial context in which it was used.” [NOTE 22²⁹] The correct perspective on the meaning of good faith performance and enforcement is the Agreement of the parties. The critical question is, “Has ‘X’ acted in good faith with respect to the performance or enforcement of some right or duty under the terms of the Agreement?” It is therefore wrong to conclude that as long as the agreement allows a party to do something, it is under all terms and conditions permissible. Such a conclusion overlooks completely the distinction between merely performing or enforcing a right or duty under an agreement on the one hand and, on the other hand, doing so in a way that recognizes that the agreement should be interpreted in a manner consistent with the reasonable expectations of the parties in the light of the commercial conditions existing in the context under scrutiny. The latter is the correct approach. Examples are: (1) Is it reasonable for a buyer in a particular locale or trade to expect that an express quantity term in a contract is “not really” a quantity term, but a mere projection to be adjusted according to market forces? [NOTE 23³⁰]; (2) Does a party to a sales contract that permits discretionary termination have the right to expect that the decision whether to terminate will be made on the basis of sound business criteria?

The Official Comment to § 1-203 is amended by adding the following language at the end of the first paragraph:

This section does not support an independent cause of action for failure to perform or enforce in good faith. Rather, this section means that a failure to perform or enforce, in good faith, a specific duty or obligation under the contract, constitutes a breach of that contract or makes unavailable, under the particular circumstances, a remedial right or power. This distinction makes it clear that the doctrine of good faith merely directs a court towards interpreting contracts within the commercial context in which they are created, performed, and enforced, and does not create a separate duty of fairness and reasonableness which can be independently breached. See PEB Commentary No. 10, dated February 10, 1994.

¹f a state adopts the repealer of Article 6 Bulk Transfers (Alternative A), there

should not be any item relating to bulk transfers. If, however, a state adopts Revised Article 6-Bulk Sales (Alternative B), then this line relating to bulk sales should be included.

^aamended in 1972, 1987, 1988, 1989, and 1994.

For material relating to the changes made in text in 1988 and 1989, see section 2 of Alternative A (Repealer of Article 6-Bulk Transfers), Conforming Amendment to Section 1-105 following end of Alternative B (Revised Article 6-Bulk Sales), and Technical Amendment to Article 1 following end of new Article 4A-Funds Transfers.

The 1994 change reflected the revisions to Article 8.

^aamended in 1962, 1972, 1977, 1987 and 1990.

^aamended in 1994 to reflect the revisions to Article 8..

^aamended in 1990.

^Aadded 1966.

^This new section is proposed as an optional provision to make it clear that a subordination agreement

^This does not mean that the obligation of good faith as defined in the Code will necessarily apply to all aspects of the same transaction. As written, the scope of § 1-203 is co-extensive with the Code's coverage. For example, if a loan agreement that provides for an Article 9 security interest also contains financial covenants which are not governed by the Code, § 1-203 would apply to the former and the general law of contracts would apply to the latter. *See, e.g.*, Restatement, Second, Contracts § 205 (1981).

^Farnsworth, *Good Faith Performance and Commercial Reasonableness Under the Uniform Commercial Code*, 30 U. Chi. L. Rev. 666, 667 (1963).

^See, *e.g.*, UCC §§ 2-403 (good faith purchaser); 3-302 (holder in due course); 9-307 (buyer in the ordinary course of business). On the distinction between the doctrines of good faith performance and good faith purchase, see generally *id.*

^This sparse definition found in Article 1 is expanded elsewhere in the Code for purposes of particular Articles. *See, e.g.*, §§ 2-103(1)(b); 2A-103(2); 3-103(a)(4); 4-104(c); 4A-105(a)(6). This expanded definition "is concerned with the fairness of conduct rather than the care with which an act is performed." UCC § 3-103, Comment 4.

^See Aronstein, *Good Faith Performance of Security Agreements: The Liability of Corporate Managers*, 120 U. Pa. L. Rev. 1, 31 (1971) ("Good faith [as] defined in § 1-201(19)

^Karl Llewellyn Papers, The University of Chicago Law Library, File J.X.2.K. 1, 9, *reprinted in* D. Patterson, *Good Faith and Lender Liability* 217 (1990).

§ 1-201(3). Furthermore, Comment 1 to § 1-205 ("Course of Dealing and Usage of Trade") reinforces this definition by stating:

This Act rejects both the “lay-dictionary” and the “conveyancer’s” reading of a commercial agreement. Instead the meaning of the agreement of the parties is to be determined by the language used by them and by their action, read and interpreted in the light of commercial practices and other surrounding circumstances. The measure and background for interpretation are set by the commercial context, which may explain and supplement even the language of a formal or final writing.

^Commentary recognizes the fact that course of performance is defined in Articles 2 and 2A and was originally not a part of the general definition of “Agreement” in Article 1. The concept is included here as an element of the agreement of the parties because there exists no plausible justification for excluding it. This view is strongly supported by Comments 1 and 2 to § 2-208. Comment 2, in particular, emphasizes that “a course of performance is always relevant to determine the meaning of the agreement.” *See also* Westinghouse Credit Corp. v. Shelton, 645 F.2d 869, 31 UCC Rep. Serv. (Callaghan) 410 (10th Cir. 1981) (course of performance may also be used for discerning the meaning of “Agreement” in Article 9).

The Restatement, Second, of Contracts does not reflect the Code’s isolation of course of performance in Articles 2 and 2A. The Restatement provides that all four elements -- express terms, course of dealing, course of performance, and usage of trade -- are all elements of the meaning of “contract.” *See* Restatement, Second, Contracts § 203. In fact, § 202(4) states that “any course of performance accepted or acquiesced in without objection is given great weight in the interpretation of the agreement.”

^UCC § 1-205(1)

^UCC § 1-205(2)

^UCC § 2-208(1). This definition is duplicated in § 2A-207(1).

^UCC § 1-205(3)

^See 3 A. Corbin, *Corbin on Contracts* § 570 (West Supp. 1993).

If the purpose of contract law is to enforce the reasonable expectations of parties induced by promises, then at some point it becomes necessary for courts to look to the substance rather than to the form of the agreement, and to hold that substance controls over form. What courts are doing here, whether calling the process “implication” of promises, or interpreting the requirements of “good faith,” as the current fashion may be, is but a recognition that the parties occasionally have understandings or expectations that were so fundamental that they did not need to negotiate about those expectations. When the court “implies a promise” or holds that “good faith” requires a party not to violate those expectations, it is recognizing that sometimes silence says more than words, and it is understanding its duty to the spirit of the bargain is higher than its duty to the technicalities of the language.

Id. Reiter & Swan, *Contracts and the Protection of Reasonable Expectations*, in *Studies in Contract Law* 1, 11 (B. Reiter & J. Swan eds. 1980) (“[T]hroughout the law of contract, a striving to protect reasonable expectations is visible. . .”).

^See, e.g., *Southern Concrete Servs. v. Mableton Contractors, Inc.*, 407 F. Supp. 581, 19 UCC Rep. Serv. (Callaghan) 79 (N.D. Ga. 1975), *aff’d mem.*, 569 F.2d 1154 (5th Cir. 1978); *Division of Triple T Serv. v. Mobil Oil Corp.*, 304 N.Y.S.2d 191, 6 UCC Rep. Serv. (Callaghan) 1011 (Sup. Ct. 1969).

^For a non-Code decision which is consistent with this approach, see *Southwest Savings and Loan Association v. Sunamp Systems, Inc.*, 838 P.2d 1314 (Ariz. App. 1992) (holding that inquiry does not stop with recognition that lender had general authority in written loan agreement to take the particular action, but inquiry extends to whether lender exercised that authority “for a reason beyond the risks” assumed by borrower in loan agreement, or beyond borrower’s “justified expectations,” in the context of how a reasonable lender might act).

^Patterson, *supra*, at 143. Good faith is sometimes the basis of an implied term to fill a gap or deal with an omitted case, e.g., the duty of cooperation frequently imposed on a party whose cooperation is essential and not unreasonably burdensome; or, the duty to give notice within a reasonable time of some important fact of which the other party

would otherwise be unaware. See § 2-309(3) and Comment 8; 2 Farnsworth on Contracts §§ 7.17, 7.17a (1990). A breach of such duties gives rise to a cause of action for breach of the contract of which the implied term becomes a part. Although such a cause of action arguably has the same practical content as a cause of action based upon a purported breach of § 1-203

^Cases reaching this conclusion include *Management Assistance, Inc. v. Computer Dimensions, Inc.*, 546 F. Supp. 666 (N.D. Ga. 1982), *aff'd* 747 F.2d 708 (11th Cir. 1984), and *Chandler v. Hunter*, 340 So. 2d 818, 21 UCC Rep. Serv. (Callaghan) 484 (Ala. Civ. App. 1976). A contrary conclusion was reached in *Reid v. Key Bank of Southern Maine, Inc.*, 821 F.2d 9, 3 UCC Rep. Serv. 2d (Callaghan) 1665 (1st Cir. 1987).

^UCC § 1-201(11)

^See UCC §1-103

^See UCC § 1-106(1)

^Kastely, *Stock Equipment for the Bargain in Fact: Trade Usage, "Express Terms," and Consistency Under Section 1-205 of the Uniform Commercial Code*, 64 N.C. L. Rev. 777, 780 (1986).

^UCC § 2-202, Comment 1.

^See *Columbia Nitrogen Corp. v. Royster Co.*, 451 F.2d 3, 9 UCC Rep. Serv. (Callaghan) 977 (4th Cir. 1971).